

Role of Megabanks in Euro Debt Crisis Should Inform Congress to Strengthen Wall Street Reform Bill in Conference

By U.S. Senator Ted Kaufman

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Mr. President, we are about to go to a conference on the financial reform bill for Wall Street reform. I want to spend a few minutes to talk about some of the provisions that I think are extremely important to survive in conference.

What brought my attention to speak today is what is going on in Europe right now. You will hear people talk about this bill, and they will say: Well, there is no problem anymore. We have straightened out the mortgage problem. This all happened. Some kind of a typhoon came through here and wrecked the housing business. If we get that straightened out, we can move right on.

I do not see it that way. I do not look at it as some kind of natural disaster. Clearly, the housing bubble was a big part of it, but there were still systemic problems in our financial system which have been around for quite a while. If you go back and look at the 1929 Depression, in 1933, the Senate of the United States and the House and the President got together and we made rules and we made laws to correct it so it would never happen again. We passed a bill such as Glass-Steagall which basically said if you want to be a commercial bank, that is fine. But if you want to be a commercial bank, you cannot be an investment bank. We put in the uptick rule on short selling. We put in margin requirements. We created the FDIC. The Congress of the United States legislated because it was such a serious problem.

For 50, 60 years we did not have a major problem. We had problems, but not major problems. Think about before 1929. The 19th century was full of bank panics. What happened? Why did we go through 50 or 60 years without a problem?

I think when you look at it, you have to say we made some major mistakes during the late 1990s and into the 2000s in the way we carried on our business in the financial market. One by one, we stripped away these protections. It culminated in 1999 with the Graham-Leach-Bliley Act, which did away with Glass-Steagall. We allowed commercial banks to get into all kinds of businesses, all kinds of risky businesses. We allowed them to get into derivatives. Our regulators went home and said: Hey, look, we didn't need regulation. Let the free market work it out. Alan Greenspan and others were saying: Let the market work it out.

This was not just about housing. Housing is what set it off, but what really set it off was we basically said, we do not need any regulators. We decided to do play football, and we said: Do you know what. Those referees on our football field keep blowing the whistle. How can we keep playing when we have the referees blowing the whistle all the time,

closing things down? Let's get these referees off the field and let the people play. We all know what happens in football, and we all saw what happened here.

What concerns me the most is--I think we have done some good things to deal with the housing market and eliminating the housing bubble--what we see happening in Europe should send a real chill through the spine of everyone in this body. We have seen the EU and the IMF scramble to put together an almost \$1 trillion emergency package to forestall a full-blown series of sovereign debt crises in one country after another. Sound familiar? Lehman Brothers, Bear Stearns, AIG, and on. Greece, Spain, Portugal. Sound familiar? We see what is happening there.

German and French banks alone have more than \$900 billion in exposure to Greece and other vulnerable Euro countries, including Ireland, Portugal, and Spain. Meanwhile, our top five banks have an estimated \$2.5 trillion in exposures to Europe.

On the front page of today's Wall Street Journal there is an article on how European banks are saddled with higher funding costs because of skepticism on whether the EU-IMF bailout plan will work.

I am a person who believes in the market. Look at what the market is saying. The market is saying: You are going to have to pay a higher funding cost. Do you know why? Because we are at risk. That is a sign. It is not for people to sit around. We are at risk. Just like right now, our major banks borrow at lower rates than every other bank in America because people believe 75 basis points or 80 basis points--because people believe the market sends a clear message that they think those banks are still too big to fail. So this is an example of what is going on in Europe and why we must make sure the bill that comes out of conference is strong and why we must make sure we have done away with too big to fail.

There are five issues I wish to talk about on the floor and go over them. No. 1 is Merkley-Levin. People on the floor know that is a good amendment, the President of the United States. The Volcker rule: Folks have come to this floor and said the Volcker rule is already in this bill. Well, this bill says the Rucker rule is in here. The Volcker rule, as you will remember, says that commercial banks, banks, should not be involved in proprietary trading.

If you want to be a commercial bank, be a commercial bank. That is what we set up when we set up Glass-Steagall. We said be a commercial bank. That is going to be a low-risk business. You may not get as high a return if that is what you want to do, but do not get into these risky things, do not get into this investment banking. Basically, what this says is, do not get into the proprietary trading because proprietary trading can be risky. If you want to be a commercial bank, be a commercial bank. So what the present bill says is that it supports the Volcker rule. It says you can do proprietary trading, but then it sends it to the regulators, and says to the regulators, you can modify this.

First of all, what is the Congress of the United States doing saying to regulators, you can modify this? The buck stops here with us. We should lay down what the rules are. That is what we did in 1929. We passed laws. We made what the laws were. We do not turn them over to regulators. By the way, many of these regulators--not the people but the people who were in those positions--were the reason why we got to where we are today, because they are the ones who pulled the referees off the field.

So one of the things we should look at clearly coming out of this conference is a strong Volcker rule, not one that can be modified by the regulators, and that is basically the Merkley-Levin amendment.

The second thing is the provision by Senator *Lincoln*, the provision on swaps dealers. The conference report should include Senator *Lincoln*'s provision to prohibit banks with swap dealers from receiving emergency Federal loans. Again, if you want to be a bank, be a bank. Do not get into these high-risk businesses.

By forcing megabanks to spin off their swap dealer into an affiliate or separate company, section 716 of the Senate bill would help restore the wall between the government-guaranteed part--the FDIC-insured part--of the financial system and those financial institutions, entities, that remain free to take on greater risk.

If you want to have risk, become an investment bank. Go into risky business. Do not do that with commercial banks. Do not be luring our commercial banks with up to, potentially, \$2.5 trillion in exposure to Europe. How many derivatives? How much are they still in derivatives? That is what this is about. Let's get them out of the risky business of derivatives.

Allowing massive derivatives dealers to be housed within banks creates a moral hazard. Forcing banks to spin off large derivatives dealers would end this moral hazard and force swaps dealers to adequately price and capitalize the risks associated with these activities. Again, commercial banks should be commercial banks. They should not be in high-risk businesses.

Senator *Collins*' capital standards amendment. The conference report should include some form of the Collins amendment to ensure that bank holding companies and systemically significant nonbank financial institutions are subject to capital and leverage requirements as stringent as those that insured depository institutions face under existing prompt corrective action regulations. That just makes good sense. Set up the same regulations.

This amendment would, therefore, raise the capital bar for our largest financial institutions, requiring them to hold more committed and reliable forms of capital, namely, common equity and retained earnings. This makes good sense.

Representative Kanjorski's systemic risk amendment. The conference report should include Representative Kanjorski's amendment to require the council, following consultation with applicable prudential regulators, to take action against a financial

institution that poses a ``grave threat" to U.S. financial stability. This just makes good sense.

These actions might include the imposition of enhanced capital and other prudential standards, activity restrictions, and the sale of assets or business lines, among others. This is what the regulators should be doing. Hence, this amendment gives regulators added tools and authority to impose strict standards and take preemptive actions against financial institutions that pose outsized risks to the overall system before a full-blown financial crisis occurs.

We cannot do what we have done before. We cannot say: Oh, everything is going great, and then one day wake up with this incredible hangover. We cannot wait for a full-blown financial crisis. That is key. Resolution is one thing--how to resolve it once you get there--but we have to spend our time on prevention to make sure this never happens again, we never get to that point.

Finally, Representative Speier's leverage amendment. The conference report should include Representative Speier's amendment to require the Federal Reserve to set a minimum leverage level of 15 to 1 on all systemically significant financial institutions. This is good financial practice.

A statutory leverage limit of this kind will ensure a capital floor for our largest banks and help ensure that regulators do not miss the forest for the trees as they calibrate risk-based capital standards.

These are five important pieces to the puzzle that we should include in this financial regulatory reform when it comes back from the conference. This is our way to assure that never again do millions of Americans find themselves out of work, millions of Americans find themselves without a house, and that American taxpayers never again--never again--will have to bail out the large banks.